Axia Advisory

Market Commentary

As of December 31, 2018

Economy & Market Review

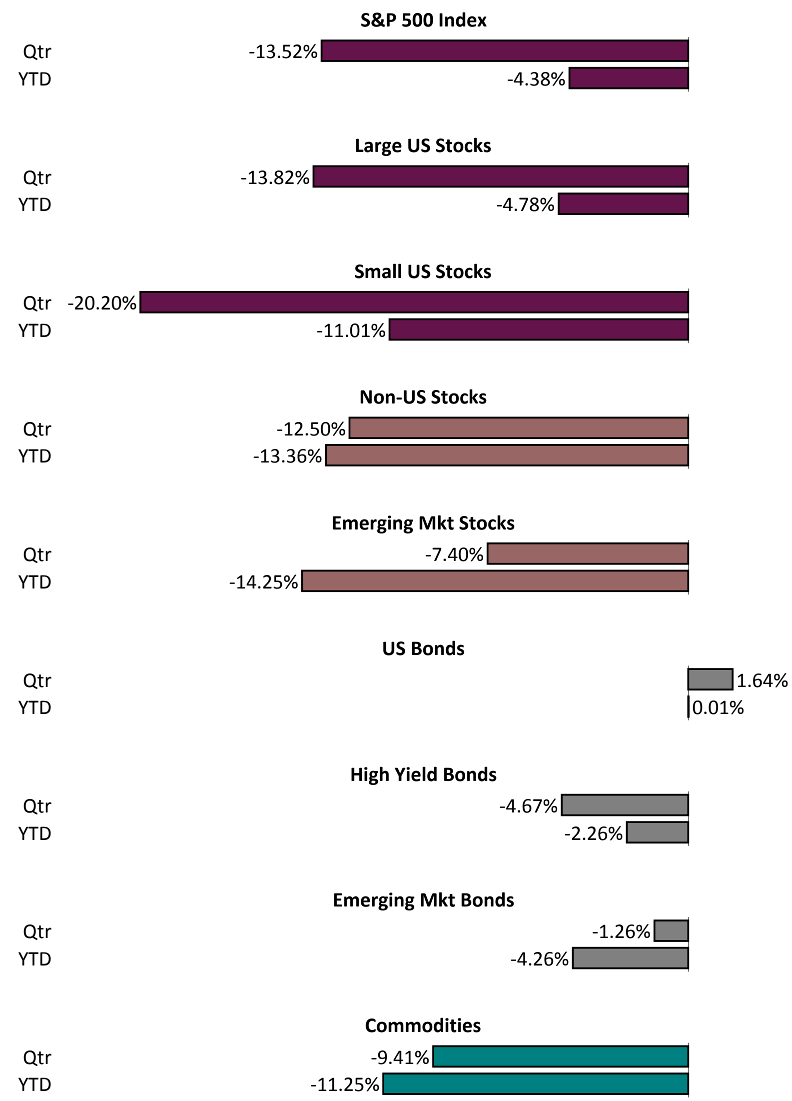
Fourth Quarter 2018

The “word of the day” can be found on everything from Mister Roger's Neighborhood (a childhood T.V. favorite) to wall calendars. The “word of the day” for equity markets during the fourth quarter was UN-CER-TAIN-TY. As the equity market shows, it reacts poorly to uncertainty. A few main topics are driving current concerns: the Fed's response, diminishing growth and trade/tariffs. On October 3rd, Fed President Jay Powell made the following comment, “We may go past neutral, but we're a long way from neutral at this point, probably.” sending markets lower. Since then, the Fed has sent multiple signals in all directions increasing ambiguity. Slowing global growth seems apparent, but additional questions remain whether a global recession is imminent. Add to the list, the US and China's currently inflexible trade stances and equity markets developed more volatility. As a result, the US large caps declined 13.5% during the quarter and 4.4% for the year with small cap US stocks dropping 20.2% and 11.0%, respectively. International developed and emerging markets outpaced the US during the quarter, but trailed over the last year.

Upcoming quarterly US economic growth will likely slow, but probably not experience negative growth yet. Third quarter GDP growth settled at 3.4%, below second quarter's growth of 4.2%, but still strong. Estimates for fourth quarter growth revert back to the mid-to-high 2% range. The US gained 312,000 new jobs in December well above the 182,000 estimate. Near historic low unemployment of 3.9% and more people seeking employment have led to slight inflation pressures. With inflation increasing somewhat and growth slowing, the Fed faces a challenging balancing act.

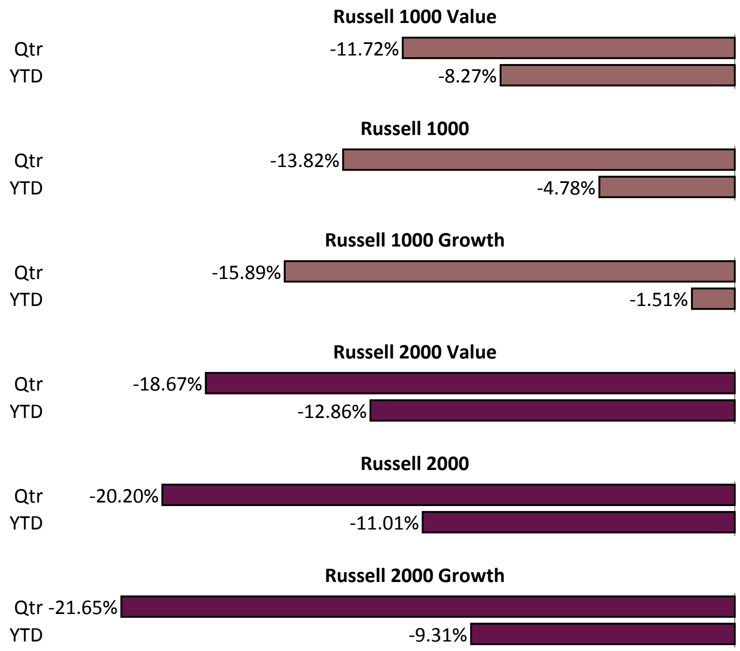
Historically speaking, ignoring the chatter surrounding volatile markets and identifying that fearful selling or overly enthusiastic buying provide opportunities to build wealth for investors with long-term goals. Also, keep in mind that what resembles new volatility is actually fairly normal. It's important to understand that some investors have been lulled into a false sense that markets are naturally calm by the abnormally low volatility experienced over the past years of this bull market.

Global Market Performance



U.S. Equity Markets

U.S. Equity Style Performance

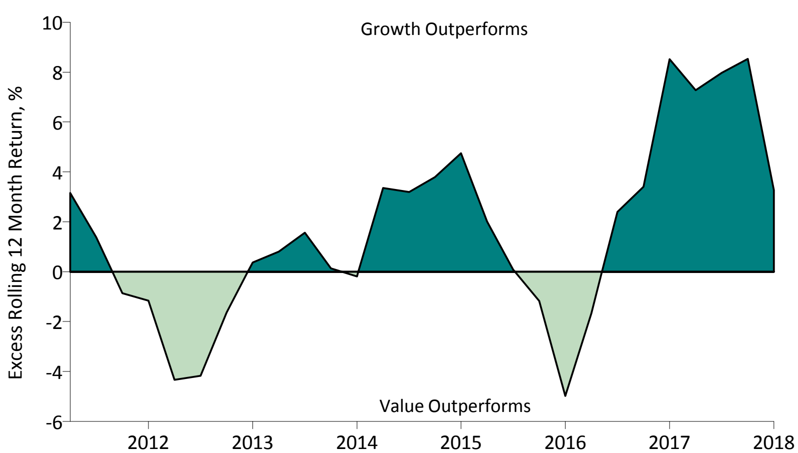


While the US is late in the economic cycle, the private sector is still fairly healthy, consumer demand remains resilient, and the 2017 tax cuts may continue to aid this market near-term. Although certainly not cheap nor extremely expensive, equity valuations have dropped with the recent market correction. The trailing 12-month P/E ratio for the S&P 500 is 16.9, below the 5-year (19.3) and 10-year (17.4) averages. Although indicators appear mostly positive, some recent adverse signs materialized in the housing and manufacturing industries.

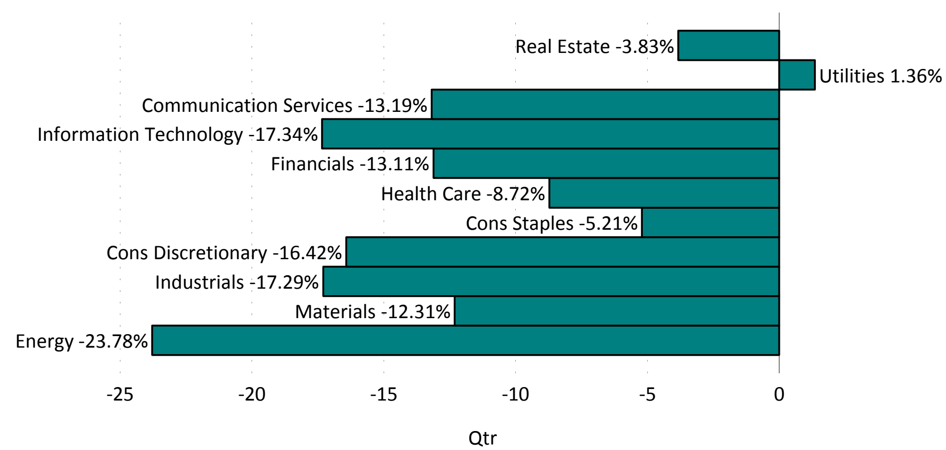
The Russell 1000 Index of large cap stocks declined 13.8% for the quarter and 4.8% for the year. Growth stocks are on their longest period of outperformance versus value stocks, but value stocks marginally outperformed growth during the quarter. Following periods of growth's outperformance by 1% or more over 10 years, value has outperformed over the next 3 years. In a down year for the stock market, it is also not surprising that small cap stocks underperformed large companies for both the quarter and over the last year.

Only one equity sector had a positive return for the quarter – utilities. As both a defensive and yield-driven sector, utilities benefited from the equity selloff and the decrease in interest rates. The worst performing sectors were the very cyclical sectors: energy, information technology and industrials. As investors began assessing a slowdown possibly leading to a recession, cyclical companies suffered.

Growth Relative to Value (Russell 1000)

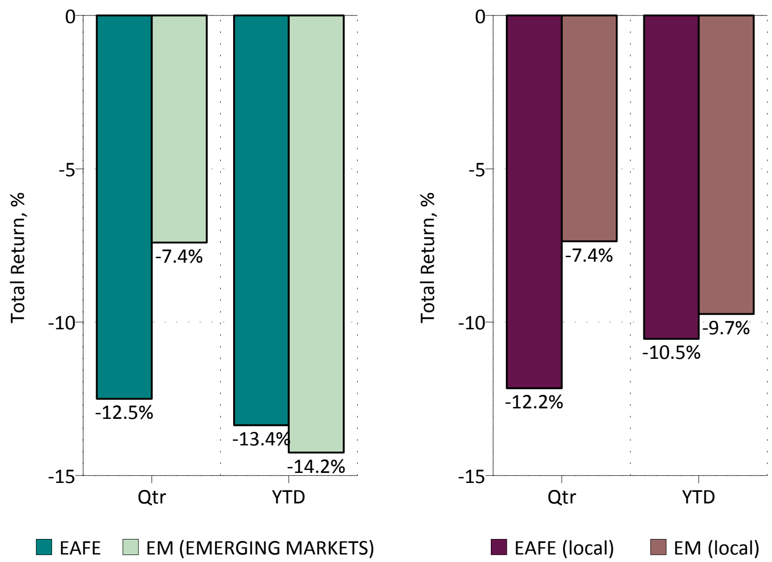


U.S. Equity Sector Performance (S&P 500)



International Equity Markets

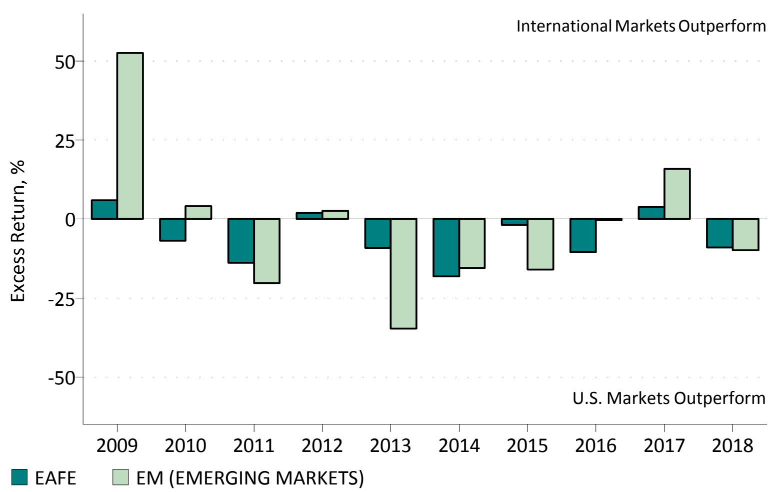
Non-U.S. Equity Performance



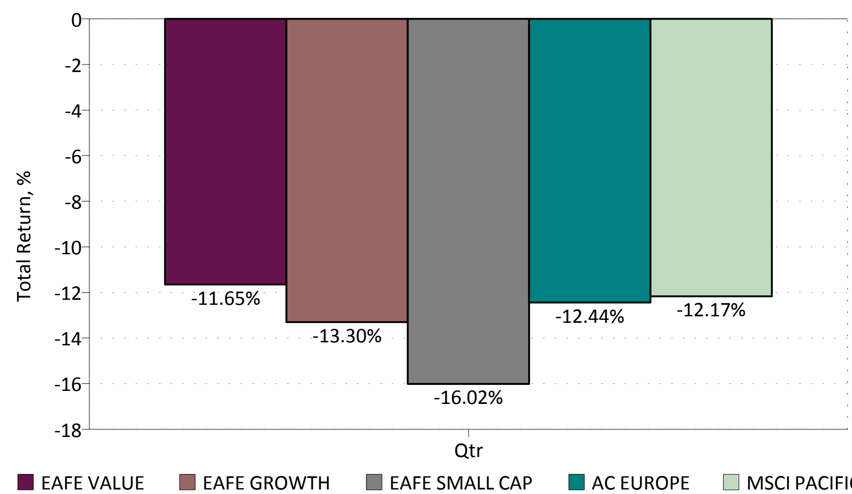
Although European economies are earlier in the economic cycle, their growth has been slowing since late 2017. The European Commission expects the region's growth to slow to 1.9% in 2019 and 1.7% in 2020. Based on the MSCI EAFE Index, developed international markets had negative returns for both the quarter and the year. Brexit and the Italy/EU fiscal dispute could provide additional explanations for future volatility. With the recent divergence between central bank policies in the US and other parts of the world, global credit cycles have become desynchronized. This desynchronization provides both challenges and opportunities around the globe.

The IMF predicts that emerging market (EM) growth next year will remain stable with other major economies offsetting China's slowdown. The MSCI China Index lost 18.9% for the year, but outperformed the US in the last quarter. The broader MSCI Emerging Market Index was down 14.3% for the year and 7.4% during the quarter. Based upon numerous investment company capital market assumptions, emerging markets appear to have higher return potential than US markets over the next 10-15 years. Emerging markets also continue as one of the more unpredictable asset classes historically. So, it is important to not overlook the challenges EM economies face such as political instability, currency fluctuations, and reduced financial transparency versus more developed markets.

Non-U.S. Equity Returns Relative to U.S. (S&P 500)

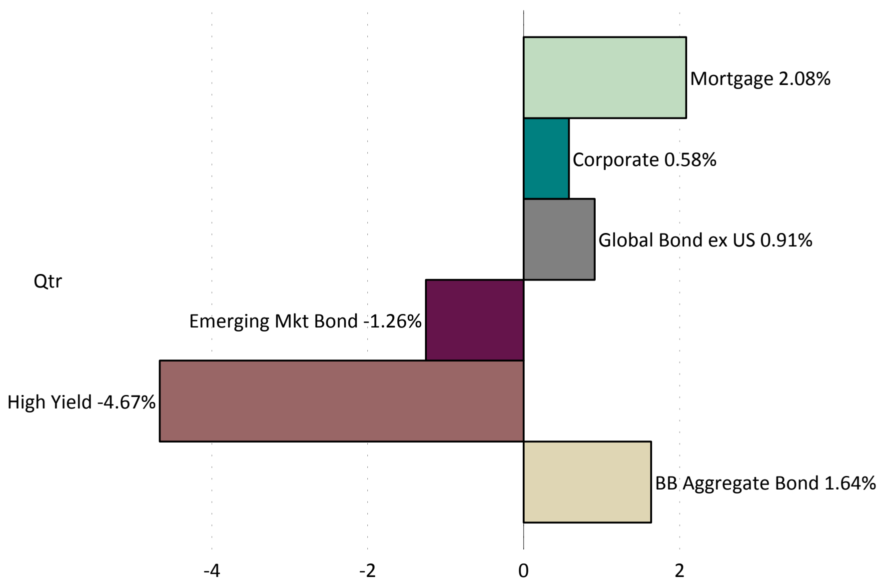


Style and Regional Non-U.S. Equity Performance



Fixed-Income Markets

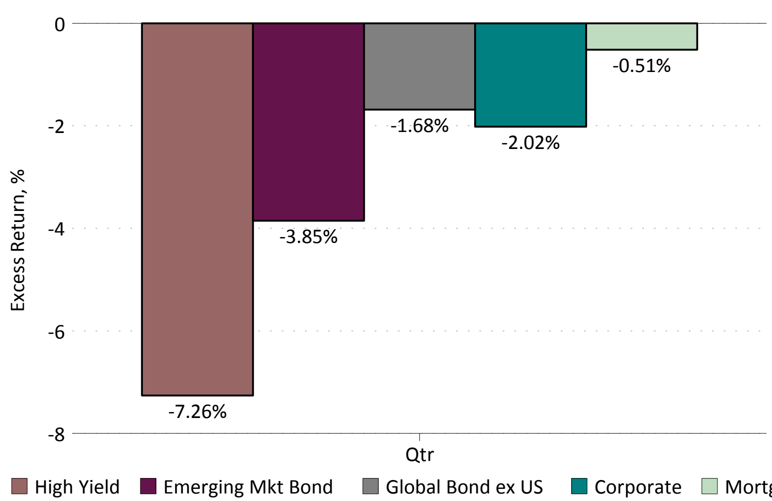
Fixed Income Performance



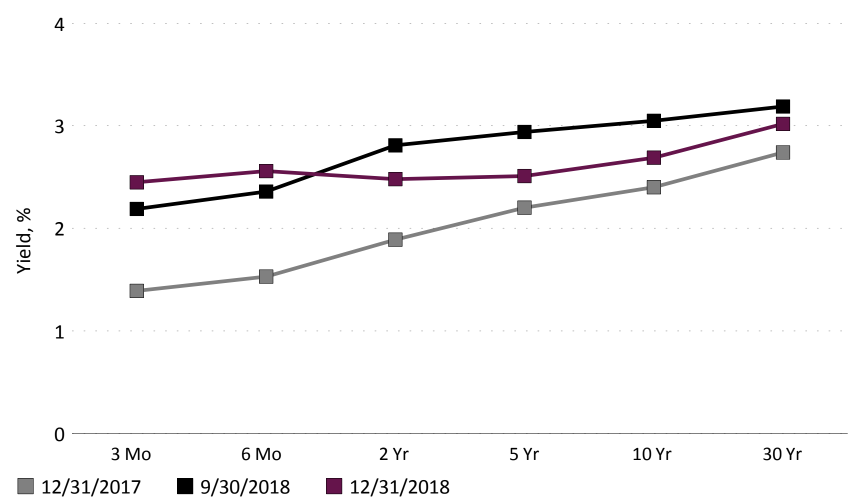
During the quarter, fixed income returns generally provided a positive ballast to the equity markets. The Bloomberg Barclays US Aggregate Bond Index, a broad measure of the bond market, increased 1.6% for the quarter, but finished unchanged for the year. As the bond market processed the possible conclusion of rate increases and slowing growth, the US 10-Year Treasury yield fell from 3.23% on November 8th to 2.69% at year-end. Emerging market and high yield bonds were the two outliers with negative returns for the quarter. High yield bonds were impacted by concern that slowing growth might begin producing higher default rates. With similar concerns regarding credit quality in general and recession questions, credit sectors generally underperformed treasuries.

As expected, the Federal Open Market Committee raised rates again in December, but lowered its 2019 projection to two increases. The short-end of the yield curve actually inverted compared to 2-year and 5-year bond yields. Traditionally, the spread between the 2-year and 10-year has been the indication for a yield curve inversion. Currently, the 10-year has a slightly higher yield than the 2-year. Yield curve inversion has many times been a precursor to recession, but some believe it may not apply with the recent artificially low rates.

Excess Performance to Treasuries



Yield Curve



2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Annualized Return
		Gold 29.24%						Small Cap Stocks 21.31%	Emerging Mkt Stocks 37.75%		
	Emerging Mkt Stocks 79.02%	Small Cap Stocks 26.85%		Emerging Mkt Stocks 18.63%				High Yield 17.49%	International Stocks 27.77%		
	High Yield 57.51%	Emerging Mkt Stocks 19.20%		International Stocks 17.39%				Large Cap Stocks 12.05%	Large Cap Stocks 21.69%		
	International Stocks 42.14%	Commodities 16.83%		Large Cap Stocks 16.42%		Large Cap Stocks 13.24%		Commodities 11.77%	Small Cap Stocks 14.65%		
	Large Cap Stocks 28.43%	Real Estate 16.36%	Real Estate 15.99%	Small Cap Stocks 16.35%		Real Estate 12.49%		Emerging Mkt Stocks 11.60%	Gold 12.66%		
	Small Cap Stocks 27.17%	Large Cap Stocks 16.10%	Gold 8.93%	High Yield 15.58%	Small Cap Stocks 38.82%	US Bonds 5.97%		Real Estate 8.76%	60/40 Blended Index 12.07%		
	Gold 25.04%	High Yield 15.19%	US Bonds 7.84%	60/40 Blended Index 11.09%	Large Cap Stocks 33.11%	60/40 Blended Index 5.51%		Gold 8.10%	Intl/EM Bonds 10.41%		
	60/40 Blended Index 20.62%	60/40 Blended Index 12.84%	Intl/EM Bonds 5.88%	Real Estate 10.94%	International Stocks 15.78%	Small Cap Stocks 4.89%	Real Estate 15.01%	60/40 Blended Index 7.85%	Real Estate 7.62%		
	Commodities 18.91%	International Stocks 11.60%	High Yield 4.38%	Intl/EM Bonds 10.60%	60/40 Blended Index 14.85%	High Yield 2.50%	Large Cap Stocks 0.92%	Intl/EM Bonds 5.77%	High Yield 7.48%		
US Bonds 5.24%	Intl/EM Bonds 18.31%	Intl/EM Bonds 8.60%	Large Cap Stocks 1.5%	Gold 8.26%	Real Estate 13.94%	Intl/EM Bonds 2.08%	US Bonds 0.55%	International Stocks 5.01%	US Bonds 3.54%	Real Estate 8.35%	5.33
Gold 4.32%	US Bonds 5.93%	US Bonds 6.54%	60/40 Blended Index 0.49%	US Bonds 4.22%	High Yield 7.42%	Gold 0.12%	60/40 Blended Index 0.11%	US Bonds 2.65%	Commodities 1.70%	3-month T-Bills 1.87%	0.53
3-month T-Bills 2.06%	3-month T-Bills 0.21%	3-month T-Bills 0.13%	3-month T-Bills 0.1%	3-month T-Bills 0.11%	3-month T-Bills 0.07%	3-month T-Bills 0.03%	3-month T-Bills 0.05%	3-month T-Bills 0.33%	3-month T-Bills 0.86%	US Bonds 0.01%	3.64
2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	
Intl/EM Bonds (3.87)%	Real Estate (29.76)%		Small Cap Stocks (4.18)%	Commodities (1.06)%	US Bonds (2.02)%	Emerging Mkt Stocks (1.82)%	Intl/EM Bonds (2.42)%			Gold (0.93)%	3.97
Real Estate (10.00)%			Commodities (13.32)%		Emerging Mkt Stocks (2.27)%	International Stocks (3.44)%	Small Cap Stocks (4.41)%			High Yield (2.26)%	6.92
60/40 Blended Index (23.25)%			International Stocks (13.33)%		Intl/EM Bonds (4.13)%	Commodities (17.01)%	High Yield (4.64)%			International/EM Bonds (3.17)%	4.14
High Yield (26.39)%			Emerging Mkt Stocks (18.17)%		Commodities (9.52)%		International Stocks (5.25)%			60/40 Blended Index (3.71)%	4.64
Small Cap Stocks (33.79)%					Gold (27.33)%		Gold (12.11)%			Large Cap Stocks (4.78)%	7.30
Commodities (35.65)%							Emerging Mkt Stocks (14.60)%			Small Cap Stocks (11.01)%	6.75
Large Cap Stocks (37.60)%							Commodities (24.66)%			Commodities (11.25)%	-7.24
International Stocks (45.24)%										International Stocks (13.78)%	0.73
Emerging Mkt Stocks (53.18)%										Emerging Market Stocks (14.25)%	0.42